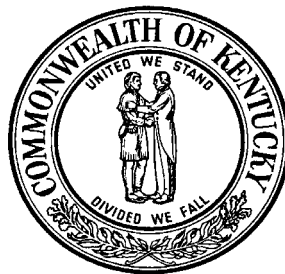


**LETTER FROM THE AUDITOR OF PUBLIC ACCOUNTS
DEPARTMENT OF VETERANS AFFAIRS**

**In Reference to the Statewide Single Audit
of the Commonwealth of Kentucky**

**For the Year Ended
June 30, 2005**



**CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS
www.auditor.ky.gov**

**105 SEA HERO ROAD, SUITE 2
FRANKFORT, KY 40601-5404
TELEPHONE (502) 573-0050
FACSIMILE (502) 573-0067**

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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky
Honorable Ernie Fletcher, Governor
Brig. Gen. Leslie E. Beavers, U.S. Army (Ret)
Commissioner, Department of Veterans Affairs

MANAGEMENT LETTER

KRS 43.090 (1) requires the Auditor of Public Accounts, upon completion of each audit and investigation, to prepare a report of all findings and recommendations, and to furnish copies of the report to the head of the agency to which the report pertains, and to the Governor, among others. This KRS also requires the Department of Veterans Affairs to, within 60 days of the completion of the final audit, notify the Legislative Research Commission and the Auditor of Public Accounts of the audit recommendations it has implemented and those it has not implemented and any reasons therefore. We are providing this letter to the Department of Veterans Affairs in compliance with KRS 43.090.

The work completed on the Department of Veterans Affairs is part of the overall opinions included in the audit of the Commonwealth of Kentucky's Comprehensive Annual Financial Report (CAFR) and Statewide Single Audit of Kentucky (SSWAK). Findings and recommendations for agencies, audited as part of the CAFR and SSWAK, if applicable, can be found in the Statewide Single Audit Report. This report can be obtained on our website at www.auditor.ky.gov.

In planning and performing our audits of the Commonwealth for the year ended June 30, 2005, we considered the Department of Veterans Affairs' internal control over financial reporting and compliance with laws, regulations, contracts and grant agreements in order to determine our auditing procedures for the purpose of expressing opinions included in the audit of the CAFR and SSWAK and not to provide an opinion on internal control or on compliance.

However, during our audit we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. The SSWAK is a separate report dated March 9, 2006 and contains all reportable conditions and material weaknesses in the Commonwealth's internal control structure and also contains all reportable instances of noncompliance. This letter does contain the Department of Veterans Affairs' findings and our recommendations that have been extracted from the SSWAK report along with other matters that have been identified.



To the People of Kentucky
Honorable Ernie Fletcher, Governor
Brig. Gen. Leslie E. Beavers, U.S. Army (Ret)
Commissioner, Department of Veterans Affairs

We will review the status of these comments during our next audit. We have already discussed many of these comments and suggestions with various Department of Veterans Affairs personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Included in this letter are the following:

- ◆ Acronym List
- ◆ Schedule of Expenditures of Federal Awards
- ◆ Notes to the Schedule of Expenditures of Federal Awards
- ◆ Findings and Recommendations
- ◆ Summary Schedule of Prior Year Audit Findings

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
March 9, 2006

LIST OF ABBREVIATIONS/ACRONYMS

CAFR	Comprehensive Annual Financial Report
CFDA	Catalog of Federal Domestic Assistance
FY	Fiscal Year
KDVA	Kentucky Department of Veterans Affairs
KRS	Kentucky Revised Statutes
OMB	Office of Management and Budget
SCG	State Cemetery Grants
SEFA	Schedule of Expenditures of Federal Awards
SSWAK	Statewide Single Audit of Kentucky

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

CFDA #	Program Title	Expenditures		Provided to
		Cash	Noncash	Subrecipient
<u>U.S. Department of Veterans Affairs</u>				
Direct Programs:				
64.005	Grants to States for Construction of State Home Facilities	\$	505,130	
64.203	State Cemetery Grants		901,026	
Total Department of Veterans Affairs		\$	1,406,156	\$ -

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Basis of Presentation - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Department of Veterans Affairs, except those programs administered by state universities, and is presented primarily on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Note 2 - Type A Programs

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$20 million for FY 05. The Department of Veterans Affairs had no cash programs that met the Type A program definition for FY 05.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 05-KDVA-1: The Kentucky Department of Veterans Affairs Should Monitor Grant Supported Activities to Assure Compliance With Applicable Federal Requirements**

We performed follow-up procedures during the FY 05 audit and determined KDVA still lacks internal controls over compliance with federal program requirements.

- The agency does not review expenditures for allowability as determined in OMB Circular A-87 or other State Cemetery Grants (SCG) program-specific literature.
- The agency does not review construction costs, which are paid and recorded by the Finance Cabinet, for allowability as determined in OMB Circular A-87 or other SCG program-specific literature.

Although the Finance Cabinet does administer the construction part of the SCG program, which is the majority of expenditures, KDVA is responsible for ensuring compliance with federal program requirements.

This finding was noted in the FY 04 audit and KDVA management is aware of the federal requirement and is taking appropriate steps to ensure compliance requirements are met on future projects.

According to OMB Circular A-133, Subpart C, Section .300(b), “the auditee shall maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs.”

Recommendation

We recommend that individuals involved in the SCG program review Part 6 of the Compliance Supplement to OMB Circular A-133. We recommend that KDVA then implement their choice of internal controls suggested in the Compliance Supplement. All five components of internal control should be addressed for each applicable program requirement. The agency should ensure that adequate records are maintained to provide evidence of the existence of any internal controls that are implemented.

Management’s Response and Corrective Action Plan

The Kentucky Department of Veterans Affairs (KDVA) has implemented procedures to address these issues in future grants of this type. In a state construction project the Engineering Division of the Finance Cabinet oversees all aspects of construction expenditures. The process begins by providing a project program to

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 05-KDVA-1: The Kentucky Department of Veterans Affairs Should Monitor Grant Supported Activities to Assure Compliance With Applicable Federal Requirements (Continued)**

Management's Response and Corrective Action Plan (Continued)

the Architects. This program is developed by KDVA, the Finance Cabinet, and the architect to satisfy the operational needs of KDVA and the requirements of the State Cemetery Grants Program, while keeping within the federally approved scope of the project.

The architect develops plans and specifications in compliance with the project program. These plans and specifications are issued for bid and the low bidder receives a contract, which stipulates that all materials and services, covered by the contract, are those that were selected by KDVA for the project. Once this bid is accepted we submit the final grant request to the United States Department of Veterans Affairs for approval.

When a contract is signed between the state and the contractor, all monthly invoices are submitted to the A&E firm, who reviews them for completeness and accuracy, then submits them to the project manager of the Engineering Division. He has them reviewed for completeness and accuracy and when finalized, approves them for payment by the Revenue Cabinet.

After this step, the KDVA reviews these payments and files for reimbursement from the federal government. If a discrepancy should be found, the KDVA would meet with the Finance Cabinet and discuss the discrepancy. It should be noted that the KDVA has an employee on site, every day, to observe the construction. If there are any questions or concerns at any time during any of these steps, a meeting with the general contractor, the A&E firm, the Engineering Division, and the KDVA branch manager would take place to work out these discrepancies.

The KDVA and the Finance Cabinet's Engineering Division have agreed that on any future projects of this type, the KDVA will receive copies of all paid invoices, once reviewed by the Finance Cabinet. There are also monthly progress meetings at the construction site where all of the previous mentioned organizations are represented. It is during these meetings that progress is discussed and any other issues that may arise will be worked out. We feel that by continuing KDVA involvement from the beginning of the project program development and continuing their constant presence in processing requests for payment by the contractors and, furthermore, with these new procedures in place, the KDVA will be adhering to all the federal regulations governing the State Cemetery Grants Program.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2005

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<i>Reportable Conditions</i>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 04	04-DVA-1	The Kentucky Department of Veterans Affairs Should Design and Implement Internal Controls Over Compliance With Federal Program Requirements	64.203	0	Due to improvements, this finding is downgraded to an other matter for FY 05. This finding is no longer required to be reported under <i>Government Auditing Standards</i> . See 05-KDVA-1
FY 04	04-DVA-2	The Kentucky Department of Veterans Affairs Should Monitor Grant Supported Activities to Assure Compliance With Applicable Federal Requirements	64.203	0	Due to improvements, this finding is downgraded to an other matter for FY 05. This finding is no longer required to be reported under <i>Government Auditing Standards</i> . See 05-KDVA-1

(2) Audit findings not corrected or partially corrected:

No findings for this section.

(3) Corrective action taken is significantly different from corrective action previously reported:

No findings for this section.

(4) Audit finding is no longer valid or does not warrant further action:

No findings for this section.

